

IN THE
Supreme Court of the United States

OCTOBER TERM, 1990

IN RE GERALD J. SANDERFOOT, DEBTOR.
JEANNE FARREY, f/k/a JEANNE SANDERFOOT,
Petitioner,

v.

GERALD J. SANDERFOOT,
Respondent.

On Writ of Certiorari to the United States
Court of Appeals for the Seventh Circuit

PETITIONER'S REPLY BRIEF

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v.

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PETITIONER'S REPLY BRIEF

The state divorce court gave Jeanne Farrey a lien on the home that she and Gerald Sanderfoot owned, together, during their long marriage. Under the federal bankruptcy code, Mr. Sanderfoot not only discharged all of the debts the state court ordered him to pay, he avoided Ms. Farrey's homestead lien as well. Congress has made a number of the code's provisions explicitly dependent on state law, including the state homestead exemption through 11 U.S.C. § 522. Yet the decision of the U.S. Court of Appeals for the Seventh Circuit has permitted

Mr. Sanderfoot to use the bankruptcy code to frustrate state law and to eliminate, along with his personal debts, his wife's own property interest in the family home and the equal property division required by the divorce judgment. This Court should reverse that decision.

I. NEITHER STATE NOR FEDERAL LAW PERMITS THE RESPONDENT TO USE JEANNE FARREY'S PROPERTY TO MAKE HIS "FRESH START."

In the divorce judgment, Mr. Sanderfoot received the family's home and most of the family's assets. He "was also 'awarded' in excess of \$78,000.00 of debt with Ms. Farrey being 'awarded' \$999.10 of debt." Brief for the Respondent ("Resp. Br."), p. 3. That disproportionate assignment of liabilities dramatically reduced Ms. Farrey's share of the net marital estate, to just over \$29,000.00, but the judgment in fact reflected an equal property division when the parties divorced. She had as well the "security" of the homestead lien in the divorce judgment.

The bankruptcy court eventually discharged all of Mr. Sanderfoot's personal debts, without controversy, giving him the "fresh start" promised by the code. He got far more, however, than just that. When the federal district court and the U.S. Court of Appeals permitted Gerald Sanderfoot to avoid the lien, they gave him a windfall: Jeanne Farrey's interest in the family's homestead debt-free. The divorce left her with an "equal" share of an estate reduced to account for the debts assigned to her husband, and the bankruptcy left her without any interest in the home she helped build and maintain.

A. The "Fixing of a Lien," Required By The Statute, Never Occurred Because The Transfer Of Title And The Imposition Of The Lien Were Simultaneous.

The respondent's argument is straightforward. First, the parties had "title to the real estate in joint tenancy, each holding a pre-existing undivided one-half interest"

in the property. Resp. Br. at 7-8. Then, Mr. Sanderfoot maintains, the divorce court "wholly extinguished" those rights, next awarding him sole title to the home. Then, and only then, did the divorce court "finally" award Ms. Farrey "an amount of money to balance the property division to be secured by a lien on Mr. Sanderfoot's real estate." *Id.* at 11 (emphasis in the original); *see id.* at 9. However linear the argument, it rests on a fiction.

There was only *one* divorce judgment. The court did not enter one order awarding Mr. Sanderfoot the real estate and, "finally," a separate order awarding Ms. Farrey a lien on the property. To the contrary, in the words of the federal district court, the judgment "simultaneously created" new interests: the lien for Ms. Farrey, the title for Mr. Sanderfoot encumbered by the lien. *In Re Sanderfoot*, 92 B.R. 802, 803 (E.D. Wis. 1988), Appendix, Petition for a Writ of Certiorari ("App."), p. 24a. And, in the words of the divorce judgment, each party forfeited all "right, title and interest" in the property transferred to the other party "except as expressly provided . . ." in the judgment itself. App. at 58a. Ms. Farrey's lien does indeed encumber Mr. Sanderfoot's property interest, Resp. Br. at 5, but that only presents the question without answering it.

Section 522(f)(1) permits a debtor to "avoid the *fixing* of a lien on an interest of the debtor in property. . . ." (Emphasis added.)¹ A debtor cannot ignore the lien "fixing" requirement to avoid encumbrances already in place when the debtor acquired the property. No court would permit a debtor who purchased a home subject to a mortgage to invoke the bankruptcy code in an attempt to avoid that "fixed" lien. Valid liens survive bankruptcy. *See Watkins v. Watkins*, 922 F.2d 1513, 1515 (10th Cir.

¹ The respondent repeatedly uses the term "fixed," *e.g.*, Resp. Br. at 7, 9, but "fixing" not "fixed" is the statute's dispositive term.

1991). Yet that is precisely the result Gerald Sanderfoot has asked this Court to endorse.

For all of the respondent's emphasis on the "new rights" in the divorce judgment, *e.g.*, Resp. Br. at 5, 8, the divorce judgment neither created nor extinguished Jeanne Farrey's property interest. Under Wisconsin law, she had a pre-existing ownership interest in the family's homestead and all of its other assets regardless of how the parties held title. The divorce judgment only transformed that interest, when it divided the marital estate in half, giving her a specific financial obligation secured by a lien on the homestead "in place of her pre-existing rights." *Id.* at 8. While the form changed, the parties' co-ownership of the marital estate did not.

This case does not involve "the actions of creditors that bring legal action against the debtor shortly before bankruptcy . . ." to turn a commercial debt into a judgment lien. H.R. Rep. No. 595, 95th Cong., 1st Sess. 126-27 (1977), reprinted in 1978 U.S. Code Cong. & Ad. News 5787, 6087-88.² Rather, the state divorce court divided the marital estate, co-owned by the parties and defined by state law, in a single judgment. The simultaneous exchange of the homestead property for the lien in one document "fails to meet the requirement of section 522(f)(1) that [the lien] fix on the debtor's interest in the property." Note, A "Fresh Start" With Someone Else's Property? Lien Avoidance, The Homestead Exemption, and Divorce Property Divisions Under Section 522(f)(1) of the Bankruptcy Code, 59 Fordham L. Rev. 301, 317 (1990) (forthcoming).

² Section 67a of the Bankruptcy Act, 11 U.S.C. § 107(a)(1) (1976), had a four-month lien avoidance deadline. The respondent has not noted a single pre-code decision, however, that permitted a debtor to avoid a divorce lien. When Congress replaced the entire Act in 1978, moreover, it effectively replaced that deadline with the "fixing" requirement of section 522(f)(1) and with the comprehensive preference provisions of 11 U.S.C. § 547.

B. The Bankruptcy Code Depends On State Law To Define The Homestead Exemption, And The Respondent Cannot Use It Against His Spouse.

There is no doubt that federal bankruptcy law generally supersedes state law. *McKenzie v. Irving Trust Co.*, 323 U.S. 365, 369 (1945). But that same federal bankruptcy law has incorporated state exemptions, explicitly permitting a debtor to rely on them, since at least the Bankruptcy Act of 1898. 30 Stat. 544, 548. Because some state exemptions offered debtors little, Congress in 1978 created federal exemptions, permitting debtors to choose either the state or the federal exemptions. 11 U.S.C. § 522(b)(1). Under the new law, however, the states retained their exclusive control over bankruptcy exemptions because Congress gave the states the exclusive right to define their own exemptions and to deny their residents the ability to use the federal exemptions. *Id.*

Notwithstanding this pre-eminent role conferred by Congress on the states, the respondent repeatedly maintains that "federal law will determine avoidability of the lien . . . rather than state law." Resp. Br. at 16.³ Indeed, he contends that the state exemption only "determine[s] what property is exempt (i.e. the definition of homestead) . . ." *id.* (emphasis in the original), but nothing else. The debtor wants the benefit of Wisconsin's \$40,000.00 homestead exemption without the exemption's own limitations—particularly, the specific provision of Wis. Stat. § 815.20 that exempts from execution "the lien of every judgment . . . except mortgages. . ." (Emphasis added.)

³ The respondent's reliance on *In re Heape*, 886 F.2d 280, 282 (10th Cir. 1989), for this sweeping proposition is misplaced. That case involved the "tools of the trade" provision of section 522(f)(2). Moreover, the Seventh Circuit has held that state, not federal, law defines "tools of the trade" when the debtor has elected the state exemption. *In re Thompson*, 867 F.2d 416, 421 (7th Cir. 1989).

There is not the slightest evidence that Congress intended to deny states the power to define their own homestead exemptions. To the contrary, the bankruptcy code always has depended on state law to define the property interests at stake in a bankruptcy. See, e.g., *Grogan v. Garner*, — U.S. —, —, 111 S.Ct. 654, 657 & n.9 (1991); *Butner v. United States*, 440 U.S. 48, 55 (1979). The 1978 reform act not only continued to rely on state exemptions but expanded the power of the states—even to the point of permitting states to deny the federal exemptions to their own residents.⁴

The respondent's emphasis on the fleeting comments in section 522(f)(1)'s legislative history, Resp. Br. at 19-20, 22, reinforces that very point: "The debtor may avoid a judicial lien on any property to the extent that the property could have been exempted in the absence of the lien" under state law. S. Rep. No. 989, 95th Cong., 2d Sess. 77 (1978), reprinted in U.S. Code Cong. & Ad. News 5787, 5862.

The bankruptcy code's explicit reliance on the state homestead exemption cannot be divorced from the state's own public policy, expressed in both the exemption and the divorce law. See *Warsco v. Oshkosh Sav. and Trust Co.*, 190 Wis. 87, 208 N.W. 886 (1926). That law "presumes an equal division of marital estate[s]" Resp. Br. at 3 n.2. To that end, the state even gives homestead status to a spouse's security interest in the family home. See *In re Nabbefeld*, 76 B.R. 132 (Bankr. E.D. Wis. 1987). Yet the respondent would have the Court ignore "how Wisconsin may treat the lien," Resp. Br. at 5, myopically focusing only on section 522(f).

⁴ Section 522(f) was designed to ensure that the state exemptions remained effective, permitting the debtor to avoid a lien that impaired those state exemptions. It is inconsistent, at best, to suggest that the same federal law somehow precludes the states from defining and limiting their own exemptions. See *Matter of Allen*, 725 F.2d 290, reh'g denied sub nom. *Allen v. Hale Co. State Bank*, 729 F.2d 1459 (5th Cir. 1984).

Gerald Sanderfoot had a choice. He could have elected the \$7,500.00 federal homestead exemption in 11 U.S.C. § 522(d) without any limitations. Instead, he chose the far more generous state exemption, but he cannot now escape the explicit limitations of that exemption. Under Wisconsin law, the lien imposed by the divorce judgment is a mortgage, *Wozniak v. Wozniak*, 121 Wis. 2d 330, 359 N.W.2d 147 (1984), and the homestead exemption statute has an explicit exception for the mortgage awarded Ms. Farrey by the divorce court.

Section 522(f)(1) permits a debtor to avoid a lien on homestead property only "to the extent that such lien impairs an exemption to which the debtor would have been entitled . . ." under state law. Mr. Sanderfoot was not entitled to use his homestead exemption to defeat Ms. Farrey's lien under state law, and he can fare no better under section 522(f).

II. THERE IS NO EVIDENCE THAT CONGRESS DESIGNED THE LIEN AVOIDANCE STATUTE TO DISPLACE STATE DIVORCE LAW.

While the result in this case "may be harsh," the respondent concedes, the bankruptcy code is replete with draconian provisions. Resp. Br. at 25. When Congress has, by law, permitted or dictated a "harsh" result in bankruptcy, however, it has done so clearly, explicitly, and directly. Congress has been particularly forthright—consistent with the decisions of this Court—when it adopts legislation that affects domestic relations, "a virtually exclusive province of the States." *Sosna v. Iowa*, 419 U.S. 393, 404 (1975); see *Hisquierdo v. Hisquierdo*, 439 U.S. 572, 581 (1979). There is nothing clear, explicit or direct about section 522(f), however, if the statute really means what the Seventh Circuit said it means.

Congress "recognized" the "convergence of state domestic relations law and bankruptcy law," the respondent notes, when it provided in 11 U.S.C. § 523(a)(5) that

maintenance and child support payments are not dischargeable and in section 522(c) that even exempt property can satisfy those domestic obligations. Resp. Br. at 25; *see id.* at 22. That is precisely the point. Congress has *not* been subtle with the bankruptcy code when it affects domestic relations. *See, e.g.,* 11 U.S.C. §§ 362(b)(2), 363(g)-(i), 524(a)(3) and (b), 541(a)(2) and (5)(B), 726(c). Yet the respondent contends that Congress, somehow by inference, has silently mandated a catastrophic change in state divorce law by permitting a debtor to avoid a homestead lien that secures an equal property division judgment.⁵ Neither the statute's language nor its context and history support that conclusion.

Both parties in this case claim the high ground of statutory interpretation: the text. The Seventh Circuit's application of the law to Gerald Sanderfoot's bankruptcy leaves Jeanne Farrey with nothing after 20 years of marriage. Even were that the inevitable result of the "plain meaning" of the statute, it is a result that Congress could not have imagined, let alone desired, when it revised the bankruptcy code. *See Demarest v. Manspeaker*, — U.S. —, —, 111 S.Ct. 599, 604 (1991); *Green v. Bock Laundry Machine Co.*, 490 U.S. 504, 527 (1989) (Scalia, J., concurring). There is not a "shred of evidence," in the meager legislative history of section 522(f)(1), that anyone "ever proposed or assumed such a bizarre disposition." *Id.*

To determine the meaning of the lien avoidance statute, the Court will analyze not only the text but "the design of the statute as a whole and [] its object and policy." *Crandon v. United States*, — U.S. —, —, 110 S.Ct. 997, 1001 (1990). In a familiar refrain, the respondent contends that had "Congress intended liens

⁵ If the Seventh Circuit is correct, Congress with section 522(f)(1) substantially increased the workload of the federal judiciary, provided another forum for divorce litigants, and thrust federal policy into the state system—all by implication.

for property division payments in contested divorces to be treated differently from other judicial liens, it would have so stated in clear terms." Resp. Br. at 24. That misplaces the burden of statutory interpretation. Had Congress intended section 522(f)(1) to permit a debtor-spouse to escape the consequences of a divorce judgment and take his wife's property, it would have so stated in clear terms. *See Grogan v. Garner*, — U.S. at —, 111 S.Ct. at 659. And Congress most certainly did not say that.

Under section 523(a)(5), a debtor cannot discharge court-ordered child support and maintenance obligations. A debtor can, however, discharge a debt attributable to a property award in a divorce. Gerald Sanderfoot's personal obligation to pay Jeanne Farrey \$29,208.44 may have been dischargeable but, as the respondent concedes, that is *not* the issue. Resp. Br. at 23. The issue is the status of her secured property interest: the homestead lien imposed by the divorce judgment. If it is avoidable, Jeanne Farrey will receive the same bankruptcy dividend that all of Mr. Sanderfoot's creditors received: nothing. If the lien is valid, she can enforce it to the value of the property, finally obtaining at least part of the "complete and equitable" property division promised by the divorce court. App. at 58a.

The dischargeability provisions of the code, according to the respondent, "clearly" demonstrate "that Congress did not intend to treat contested property division judgment liens different from any other judgment lien." Resp. Br. at 6. That argument, like the opinion of the Seventh Circuit, misperceives the fundamental distinction between debt and security for debt. While the debt can be discharged, the security always remains. While Gerald Sanderfoot personally may no longer owe his former wife a cent, as a result of the bankruptcy process, she retains her security in the family's home—just like the other parties who hold mortgages of record on the property. *See id.* at 10 n.4.

Ms. Farrey asks only that the bankruptcy code be applied, as written and intended, with logical results. The lien will be enforceable only to the value of the equity in the property, and any remaining debt would be discharged. *In re Donahue*, 110 B.R. 41 (Bankr. D. Kan. 1990). That respects all of the policies at issue here: the "fresh start," the states' pre-eminence in matters of family law and, through the bankruptcy code itself, the states' exclusive right to define exemptions.

Virtually every state provides for an equal or virtually equal property division on divorce. State courts often emphasize the need for divorcing spouses to reduce their reliance on alimony or maintenance and to increase their job skills and self-reliance. Ironically, the Seventh Circuit's decision eviscerates both policies. It permits debtors to ignore the decisions of the state divorce courts, and it encourages even more extensive dependence on monthly payments from a former spouse—payments not dischargeable under the bankruptcy code.

The "broad discretion" of the state divorce courts emphasized by the respondent, Resp. Br. at 25, rings hollow when a Chapter 7 bankruptcy filing can render a divorce judgment neither full nor fair nor final. Where are the "remedies which will protect all of the parties to a divorce . . ." if the Seventh Circuit's decision stands? *Id.* at 26. This Court will not find them in the respondent's brief, nor will the state divorce courts find those remedies anywhere else. There are none.

When applied to divorce decree liens on marital homestead property, the right of debtors to avoid liens under section 522(f)(1) . . . upsets the complex interrelationship between federal bankruptcy law and state divorce law. . . . If court judgments enforcing property divisions in contested divorces can be nullified by section 522(f)(1), divorce courts will be severely handicapped in implementing the mandates of state divorce statutes.

The debtor's fresh start is already protected. . . . To achieve a more proper balance between federal and state interests in the bankruptcy-divorce setting and to ensure more equitable protection of the fresh start goals of both debtor and ex-spouse, debtors should not be permitted to use federal bankruptcy law to avoid divorce decree homestead liens.

Note, 59 Fordham L. Rev. at 330 (forthcoming).

Earlier this year, this Court acknowledged the importance of the "fresh start" concept in the bankruptcy code. It limited the opportunity for a "completely unencumbered new beginning," however, to the "honest but unfortunate debtor." *Grogan v. Garner*, — U.S. at —, 111 S.Ct. at 659, quoting *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934). The cause of Gerald Sanderfoot's financial difficulty is not at issue here. He may well deserve a "fresh start," but not with his former wife's property, her only remaining asset from 20 years of marriage.

CONCLUSION

For the reasons stated above and in the petitioner's initial brief, this Court should reverse the judgment and decision of the U.S. Court of Appeals for the Seventh Circuit and reinstate the judgment of the bankruptcy court that properly refused to permit Gerald Sanderfoot to avoid Jeanne Farrey's homestead lien.

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